DRUG STORE NEWS

Vol. 8/No. 26 **Serving chains, wholesalers and high-volume independents for 57 years.** Published by Lebhar-Friedman Inc. December 8, 1986

Special Report

The Billion-Dollar Club

A billion dollars.

It has a nice ring to it. You think you'd love to be part of the club.

But even industry elites have to run fast to keep the ring from being hollow.

Billion dollar sales aren't any fun if enough profits aren't produced. Or if another heavyweight chain takes over some weaker competitors in your markets. Or operating improvements aren't paying back as quickly as you'd anticipated.

Coverage of the 10 largest drug chains in the U.S.—each with more than $1 billion annual sales—continues in this issue, exposing their highlights and describ[illegible] reasoned analysis.

Continued on page 24

0026934C DR
KEVIN KENDRICK
CONGRESSIONAL INFO SVC ILE
4520 EAST WEST HWY STE 800
BESTHESDA MD 20814

NEWS IN BRIEF

Big B continues store-opening pace

BIRMINGHAM, Ala. — Big B continued its blistering store opening schedule with 11 new units in the 12-week quarter ended Oct. 25, but slipped into the red in the period.

The 158-store chain reported a loss of $65,000 as compared to a profit of $668,000 in the previous year. Sales for the quarter increased 22% to $47 million from $38.5 million.

Apart from the rapid store opening schedule, the company blamed a decrease in gross margins and the loss of investment tax credits for the loss.

For the 38 weeks, earnings declined slightly to $2.7 million from $2.9 million, and sales were up 21% to $147 million. Big B has opened 25 stores since the start of the year.

Begley reports on 2nd quarter

RICHMOND, Ky. — Begley Co. announced a loss of $85,930, or 15¢ a share, for the second quarter ended Sept. 30, compared with a loss of $98,199, or 18¢ a share, in the same period last year. Sales for the quarter were up slightly to $17.6 million from $17.3 million.

Six-month earnings were $25,441, or 5¢ a share, vs. $131,191, or 24¢ a share, a year earlier. Sales for the period were $35.4 million, a gain of 2.3%.

Begley operates 42 drug stores, six home health care centers and 130 dry cleaning outlets.

Peoples names optical division vp/coo

ALEXANDRIA, Va. — Peoples Drug Stores has promoted Jerry Mederrick to the post of vp and coo of the optical division, which includes Eye City and 58 in-store optical centers.

The chain plans to expand Eye City to three units eventually. It is a self-service eyeglass store twinned with an optometrics center and lens manufacturing lab.

Mederrick, as former director of optical operations, was responsible for the Eye City design and many of Peoples' optical procedures.

Moore Medical earnings, sales up

NEW BRITAIN, Conn. — Moore Medical Corp., a national distributor of drugs and medical/surgical supplies, announced that earnings for the third quarter ended Sept. 26 increased 27.4% to $1.1 million, or 40¢ a share, from $881,000, or 36¢ a share, a year earlier.

Sales for the period increased 32.1% to $49.3 million from $37.4 million in the prior year.

For the nine months, net income rose to $3.3 million, or $1.16 a share, from $2.7 million, or $1.09 a share, a 20.4% gain.

Sales for the nine months were up 31.8% to $140.9 million from $106.9 million in the corresponding year-earlier period.

Jerald K. Rome, president, said the "encouraging increase in net sales can be attributed to a combination of a growing customer base as well as increased sales to the chain drug store market."

INDEX

Beauty Beat 13	Focus on people 21
Billion $ club 23	Gladson: Store Manager Training Program ... 95
Classified 97	Inside Pharmacy IP1
C. E. Lesson IP31	People in the News ... 17
Editorial 8	Product Update 96
Financial 10	

Drug Store News (ISSN 0191-7587), is published biweekly—every other Monday, monthly in December plus extra Pharmacist's Reference issue in April, as well as an extra Annual Pharmacists Guide to OTC Patient Counseling in October, by Lebhar-Friedman Inc., 425 Park Ave., New York, N.Y. 10022. Subscription rates: Infield subscribers, retailers and wholesalers, one year $19.50; two years $35. Out-of-field subscribers, manufacturers, schools, libraries and all others, one year $39. Single copy rate $2. Foreign subscriptions: Airmail only $125 per year.

Second-class postage paid at New York, N.Y. and additional mailing offices. Copyright © 1986 by Lebhar-Friedman Inc. All rights reserved. POSTMASTER: Please send address changes to Subscription Dept., Drug Store News, 305 Madison Ave., Suite 535, New York, N.Y. 10165-0079. For change of address six weeks notice to Subscription Dept., 305 Madison Ave., Suite 535, New York, N.Y. 10165-0079 is requested. Give old and new address and zip code. If possible, enclose address portion from cover on previous issue.

Vol. 8, No. 26 December 8, 1986

Pay Less installs apparel in 51 units; plans growth

WILSONVILLE, Ore.— Pay Less NW has installed apparel departments in 51 of its 193 stores and expects to exceed 100 by the end of 1987.

Until May 1986, suppliers shipped apparel for Pay Less to a K mart distribution facility, where it was transhipped to Pay Less' temporary DC in Sacramento, Calif. When the Woodland, Calif., DC opens in January, apparel will be shipped there direct by suppliers.

"Even when K mart was shipping to us," Dan Barrett, Pay Less' general manager of apparel, told *Drug Store News*, "Pay Less did its own buying. We have three buyers in New Jersey and Detroit."

20%-25% imported

Barrett also noted that "while Pay Less orders merchandise from many of K mart's suppliers, we also order from other suppliers." Approximately 20%-25% of the inventory is imported.

Depending on the size of the store, apparel departments range from 4,000 sq. ft. to 12,000 sq. ft. Currently, apparel is being installed in stores 25,000 sq. ft. and larger.

However, size is not the only determinant. Explains Barrett: "The cost of advertising is also a factor. Let's say we have eight or 10 small stores [without apparel] in a given market, and then we open a store large enough to warrant an apparel department. We would not open an apparel department in the new store because of the high cost of advertising for a single store."

No set location

There is no standard location for apparel in the store. Depending on size and configuration, apparel is located up front, on the sides or in back.

Apparel departments in king-size stores (those 60,000 sq. ft. and larger) go as high as 12,000 sq. ft. The newest department, opened in February 1986 in the 16-year-old Richland, Wash., store (66,795 sq. ft.), is 12,000 sq. ft.

Other outsize departments include Oakland (Broadway), 10,000 sq. ft., and Castro Valley (Calif.), 8,000 sq. ft.-plus.

These three stores—with wider assortments and more depth in apparel lines than conventional-sized Pay Less (averaging 30,000 sq. ft.)—are being used to test higher-ticket items (to $30) as well as fashion merchandise, especially trendy California styles. Wherever possible, results of the ongoing tests will be reflected in the conventional-sized departments.

Infant apparel tested

Pay Less continues to test a full line of infant apparel in nine stores. The test began in April 1986.

Pay Less apparel departments include men's, women's and children's apparel and accessories.

At the outset, apparel advertising was in four-color (four- and eight-page inserts and mailers). Now some of the inserts-mailers are in black and white. Photos are used in 90% of the ads. Unchanged is the policy of not including apparel in Pay Less' regular drug store ads.

There are similarities to K mart apparel departments (price points) and differences (size and fixtures).

Both target low- to medium-income shoppers. K mart's apparel departments average 15,000 sq. ft. and use advanced finger-wall fixtures (wall displays with dividers separating the various categories). Pay Less fixtures are made of chrome, with four-way and six-way racks and with four to six arms extending from the posts anchoring the racks.

Amfac Health 'is not for sale'

President Whitmire quells rumors

FOLSOM, Calif. — Despite recurring rumors, Amfac Health Care Group is not for sale, Mel Whitmire, president of the group, told *Drug Store News*.

The rumors had taken wings after FoxMeyer announced plans to enter California as a full-line distributor.

The Food and Distribution groups (including Health Care) have been losing money, but most of the losses ($61.4 million in nine months) were attributed to the Electrical group, which closed 29 branches in Texas and Oklahoma.

However, Health Group's second-quarter loss was due largely to a $12 million warehouse computerization program and receding gross margins brought on by Health Care's emphasis on hospitals.

Amfac's hospital business has been fueled by $200 million one- and three-year hospital groups contracts.

All told, the Health Care Group will finish this year with sales of $553 million vs. $484 million last year. Amfac does not break out the profits by division.

Latecomers to electronic order-entry, Amfac moved quickly to catch up. Eighty per cent of orders are now on EOE.

Amfac's marketing strategy also has changed. For many years, the wholesaler was mainly a secondary supplier; now it is concentrating on being a primary source with quicksilver results: from 20% primary distribution in January 1985 to 50% today.

"With close to 100% fill rates by the primary supplier," said Whitmire, "there is a shrinking market for secondary suppliers."

Amfac Health Care operates in 37 states. Gaps in geography are the East and Southeast. "There are no plans to fill those gaps at this time," said Whitmire, "but within five years we expect to be national."

Management values shares at $38.50

Revco shareholders to vote on LBO offer

TWINSBURG, Ohio — Revco's leveraged buyout has turned into a cliffhanger, as management races to complete a shareholders' vote weeks before favorable tax clauses expire at year's end.

Revco shareholders will decide on Dec. 16 whether to turn the company over to a management-led investor group that has offered them $38.50 in cash for each of their common shares. Owners of a majority of the 32,450,000 shares outstanding must approve the sale.

The proposed $1.25 billion leveraged buyout entered the final lap when the S.E.C. endorsed proxy material that describes the proposed sale, it was sent to shareholders, and the vote was scheduled.

Revco closed Thursday, Nov. 20, on the New York Stock Exchange at 36⅝, up ⅝.

Announced eight months ago, the purchase appeared to lose momentum earlier this year, when the Revco board balked at the group's first offer of $33 per share plus securities valued at $3 per share. The group, led by Sidney Dworkin, chairman; Bill Edwards, president; and R. Carroll Hudson, cfo, upped the ante, and the board endorsed the current offer in August.

Last month the group detailed a notes and stock sale plan to finance the buy that quelled rumors that financing is in jeopardy.

Proxy material said management expects to complete the buyout by year's end, when analysts said it will still be eligible for significant tax benefits to be eliminated under the new tax code.

The proxy said that about 40 members of Revco management will become shareholders, along with other investors.

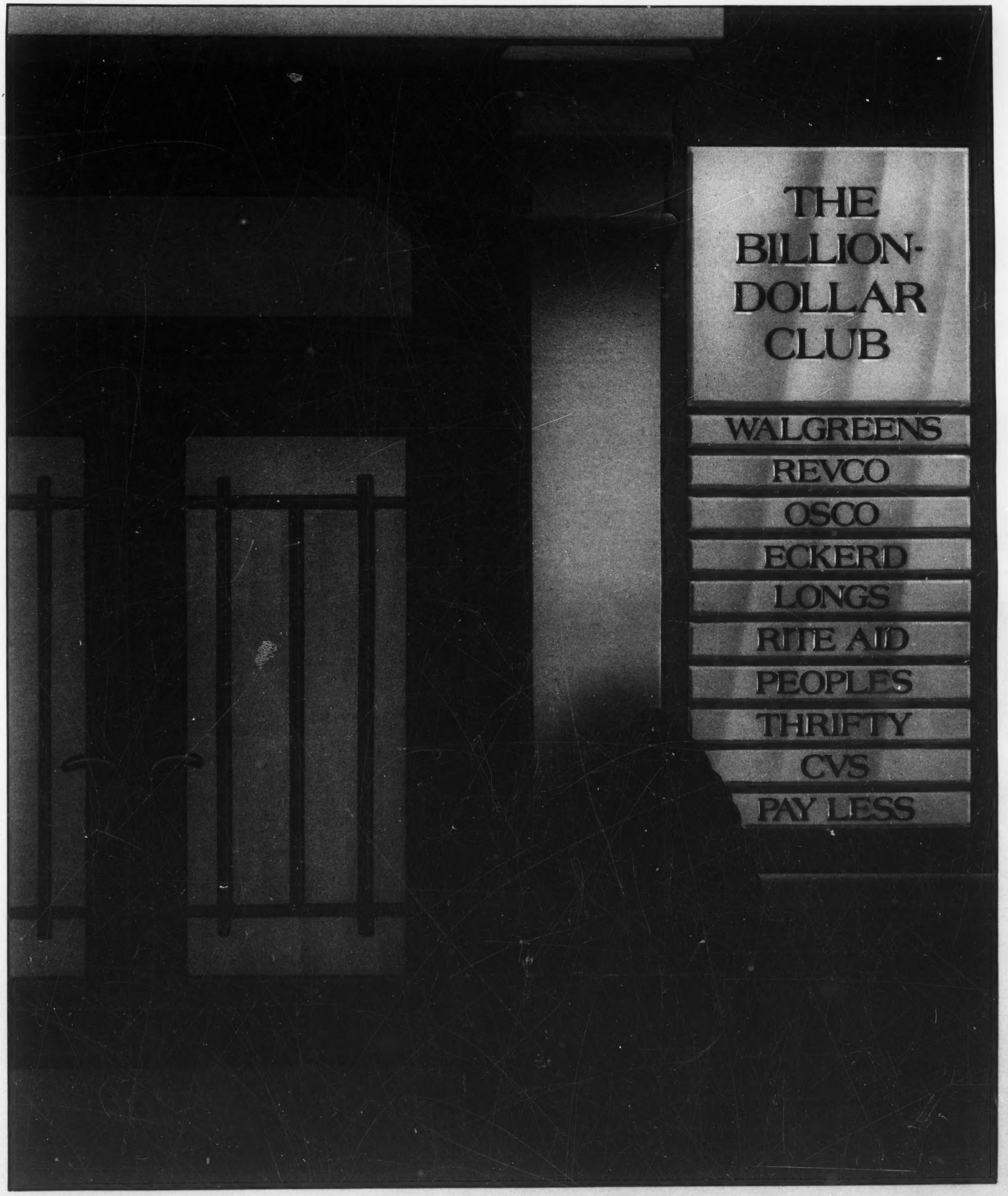
Negotiating sales

The proxy material also said that Revco is negotiating to sell its Carter-Glogau Laboratories and confirmed a *Drug Store News* report that it is preparing to close on the sale of its Private Label Formulations subsidiary.

DRUG STORE NEWS®

Special Report:

The Billion-Dollar Club



SPECIAL REPORT: BILLION $ CLUB

Billion-dollar chains mold the industry

Top of the Heap

(in millions $)

	FY end 1984	1985	1986
WALGREENS			
Sales	2,745	3,162	3,652
Net income	80.6	94.2	103.1
Stores	1,002	1,095	1,216
REVCO			
Sales	2,227.5	2,395.6	2,743.2
Net income	93.4	38.9	56.9
Stores	1,778	1,898	2,031
OSCO			
Sales[B]	1,150[C]	3,850[D]	4,780[E]
Operating profits[B]	60[C]	205[D]	216[E]
Stores	108[C]	354[D]	531[E]
ECKERD			
Sales	2,210	2,510	1,310[A]
Net income	85.4	(8.3)	NA
Stores	1,423	1,525	1,618
LONGS			
Sales	1,214	1,376	1,481
Net income	36.4	40.1	37.7
Stores	178	191	208
RITE AID			
Sales	$1,149.5	$1,360.5	$1,564.1
Net income	74.3	69.9	62.5
Stores	1,147	1,351	1,485
PEOPLES			
Sales	790[G]	1,030	1,330
Operating profits	29.3[G]	47.7	40.1
Stores	554[G]	758	832
THRIFTY			
Sales	1,299	1,404	1,501
Net income	27.9	31.9	25.0[F]
Stores	542	555	583
CVS			
Sales	876.6	1,017	1,169
Operating profits	74.2	79.0	NA
Stores	553	592	629
PAY LESS NW			
Sales	852.9	925.0	966.0
Net income	24.7	NA	NA
Stores	149	162	183

Source: *Drug Store News* research

A Six months results.
B Prudential-Bache estimates.
C Skaggs drug stores results.
D Skaggs and Osco results.
E Sav-on, Skaggs and Osco results.
F Full year net unavailable at presstime. This is net for the nine months ended 5/31/86, on sales of $1.1 billion.
G 1983 results. Performance for 1984 wasn't reported separately because Peoples was acquired by Imasco April 1, 1984 and the fiscal year was restated to reflect full year results. All Peoples results are in U.S. dollars.

INDEX

Walgreens 27
Revco 30
Osco 34
CVS 36
Eckerd 39
Longs 41
Thrifty 45
Pay Less 48
Rite Aid 50
Peoples 53

Continued from page 1

Among the 10 chains we profile here, some cleared the billion-dollar benchmark years ago. Others are fairly new.

In reality, being a billionaire doesn't change the way a chain operates, approaches problems or perceives itself. It does change the way others look at the chains—Walgreens, Revco, Osco, CVS, Rite Aid, Eckerd, Longs, Peoples, Thrifty and Pay Less NW.

In many ways, they become the industry pacesetters—in developing merchandising strategies and new store formats, the use of technology, uncovering new viable markets—even if in some instances the leadership roles aren't deserved.

Highest store volumes

More often than not, they are. Longs and Pay Less NW, for instance, use their merchandising savvy to produce the highest store volumes in the entire industry.

Longs is rather unique in the industry because it has evolved under a decentralized management system that places a great deal of operational authority in the hands of store managers and their staffs. They do their own buying and rebuying and join in chain-wide promotions only as they wish.

By keeping that merchandising control in the hands of the people who know their local markets best, Longs has built up a whopping $400 average sales per square foot and annual average store volume of $7.5 million—the best in the nation.

Pay Less NW, meanwhile, has built its popularity with shoppers by filling upper management ranks with people who had roots in the stores.

Now, that deep sensitivity to store-level concerns can be augmented by the merchandising disciplines of parent K mart, the king of general merchandise discounting.

As examples, by the end of this year, 34 Pay Less stores will have apparel departments and 75 will by the end of 1987. The department sizes will range from 4,000 to 12,000 sq. ft.

In addition, Pay Less has added 30 sku's of hardware items, using knowledge gained from Builders Square, the K mart-owned home center chain.

Without that strong knowledge base to build on, K mart wouldn't have quadrupled the annual expansion plans of Pay Less to 40-50 stores a year.

Walgreens, Rite Aid

Walgreens and Rite Aid are examples of chains that have grown in part through acquisition and the ability to spot market opportunities that offer advertising and distribution efficiencies and the chance to dominate an area.

Both also have aggressive private label programs that help to keep store margins up.

And both are in the forefront of using technology to help make better merchandising and operational decisions, while gaining tighter controls on inventory, pricing and labor expenses.

Walgreens was the first chain to automate all pharmacies chainwide, as well as one of the first chains to develop a warehouse inventory system that helped bring in-stock service up to the 95% level.

Rite Aid has so far equipped 590 pharmacies with computers and plans to be chainwide by February 1988.

Rite Aid has also installed scanners in 313 stores in markets where item price-marking isn't mandatory and plans to be chainwide by February 1989.

Moreover, the Rite Aid system links pharmacy computers with its front-end scanning systems, and data from both can be transmitted together to headquarters with a single phone call from the host computer.

Eckerd's Spartan

Eckerd has recently introduced a downsized Spartan format to 230 stores. In them, expanded greeting cards sections are placed next to cosmetics and women's hosiery at the walk-in in an effort to appeal to that 70% majority of Eckerd shoppers who are women.

A mini-convenience food department banks on the small store's ease of shopping and quick in-and-out appeal to steal fill-in visits from supermarkets and expose shoppers to Eckerd Spartan's core drug store departments.

CVS, on the other hand, hasn't had to deviate much from its top-grade systems approach to merchandising its core health and beauty aids and over-the-counter products sales. Industry experts regard CVS as one of the best, if not the best, operational chain.

CVS maintains control and margins by servicing almost 90% of what they sell in their stores through their own distribution centers.

Peoples' growth strategies

Peoples in recent years has also been forward in equipping stores with pharmacy computers—more than 300 total so far. But diversification has played an increasing role in its growth strategies.

Its latest efforts include nine Bud's deep discount drug stores and one Eye City optical center, an upscale eyeglass store that is combined with an optometrics center and a lens lab.

Thrifty has found the magic of small format stores, the Jrs., which enables Thrifty to target smaller trading areas and reach more consumers.

The strategy is also profitable on two counts: Thrifty can achieve 30%-plus gross margins in convenient downtown locations; inventory investment is less because Jr. sells only the fastest movers and carries fewer sku's.

That's why Jr. expansion will match that of Thrifty's conventional stores each year.

Revco paring sku's

Revco discovered two years ago that price-slashing wasn't a long-term winning pursuit and has recently eliminated 1,000 slow-selling H&BA and OTC sku's in some stores, while giving greater emphasis to cosmetics and greeting cards.

The giant chain, working to improve return on assets, is expected to close underperforming stores and withdraw from marginal markets.

Meantime, the Osco juggernaut of 659 stores in 39 states is expected to grow even stronger under the decentralization plan of parent American Stores.

Under the American plan, Osco and its sister divisions will each control their own real estate, buying, advertising and data systems functions.

Tax revision impact

What all 10 share with the rest of the industry is the impact of tax law revisions.

Trade sources and analysts already anticipate that retailers will cut into next year's higher earnings (because of a smaller tax bite) to precipitate bloody price wars.

If that happens, many current strategies are likely to go by the boards as independents and chains—even the billion dollar ones—struggle to survive with minimal damage.

After all, the battles that billion-dollar chains wage aren't necessarily giant; they're a series of smaller ones waged in many markets.

SPECIAL REPORT: BILLION $ CLUB

Walgreens rakes in $3.6 billion sales in '86

By Liz Parks

DEERFIELD, Ill. — Walgreens, which was the first drug chain to hit the $1 billion mark in 1978, is also likely to become the first drug chain to hit the $4 billion mark—as early as 1987.

Sales for the now nearly 1,300-unit chain hit $3.66 billion for the fiscal year ended in August. Wall Street analysts say that at the rate sales are climbing, Walgreens could pass the $4 billion a year mark sometime in early 1987.

Merrill Lynch is estimating that Walgreens will end its 1987 fiscal year with some $4.3 billion in total corporate sales, up nearly 19% over FY 1986.

The Street is also predicting that Walgreens, which they say has "the leading growth record in the drug store industry in terms of magnitude and consistency of growth," will continue to generate sales and earnings increases of between 15% and 17% a year for at least the next five years.

Fueling these high expectations is the respect that Walgreens' management commands for its accomplishments to date.

Today, in 26 out of the 36 markets where Walgreens has stores, the chain commands either the No. 1 or No. 2 market share.

Strongest growth in scripts

Moreover, Walgreens' growth is still strongest in the highly profitable and fast growing prescription end of its business.

"Walgreens' prescription franchise," says Merrill Lynch analyst Bob Roth, "engenders strong customer loyalty and is the critical element behind the company's strong sales and earnings momentum."

Roth and other analysts also point out that Walgreens is very favorably positioned for future store growth. Roth says that based on current demographics, he can see "five years of new store growth in existing markets alone." Analysts also say they expect more growth from Walgreens via aggressive acquisitions.

Acquisitions record

Since 1979, the company has acquired approximately 200 stores by acquisitions, and in just the past two years, Walgreens picked up nearly 100 stores by acquisition: the 26-unit Ribordy chain in Indiana and the 64-unit Medi Mart chain in Massachusetts.

Analysts say they expect more acquisitions down the line, particularly in the Northeast where Walgreens has said it hopes to have about 200 stores within five years.

The Ribordy acquisition essentially doubled Walgreens' store base in Indiana. All of the Ribordy stores have been remodeled, and Walgreens says they are "performing well relative to plan."

Wall Street analysts are estimating that the Ribordy acquisition only marginally diluted Walgreens' earnings in fiscal 1986 and that they will have a positive impact on earnings in fiscal 1987.

The Medi Mart acquisition last June in the Northeast is generally seen as Walgreens' "most significant" acquisition to date.

Foothold in Northeast

Medi Mart gives Walgreens geographic representation in the still rela-

Continued on page 28

Walgreens growth: 1982-1987

(corporate sales)
(sales, net in millions)

	1982	1983	1984	1985	1986	1987 Est
Sales	$2,040	$2,361	$2,745	$3,162	$3,652	$4,330
% increase	17%	15.7%	16.3%	15.2%	15.8%	18.6%
Net Income	$48.5	$65.8	$80.6	$94.2	$103.1	$122.2
% increase	38.7%	35.8%	22.5%	16.8%	9.5%	16.7%
Stores	883	941	1,002	1,095	1,216	1,400
Average store sell space (sq. ft.)	7,815	8,402	9,002	10,010	11,770	12,910
Sales per average sq. ft.	$256	$276	$300	$319	$325	$340
Major remodels	32	55	46	61	95	115

Source: Walgreens annual reports, Merrill Lynch estimates

Walgreens highlights

1979 Walgreens tests first mini-combo convenience food departments
1980 Walgreens tests first home health care centers
1983 Walgreens opens state-of-the-art computerized warehouse in Flagstaff, Ariz.
1984 Walgreens opens its 1,000th store
1984 Walgreens opens its first N.Y. store in 20 years

Source: *Drug Store News*

Walgreens: Trends in sales mix

	1981	1982	1983	1984	1985	1986
Prescription drugs	15%	16%	17%	18%	20%	22%
Proprietary drugs	13	13	13	13	13	13
Cosmetics/toiletries	10	12	12	12	11	12
General merchandise	34	33	32	32	32	31
Tobacco	7	6	6	6	6	5
Liquor/Beverages	15	15	15	14	14	14
Food services	6	5	5	5	4	3

Source: Walgreens annual reports, Merrill Lynch

Northeastern drug store operators aren't overjoyed about the prospect of a big Walgreens presence. Walgreens took its first major step there with its recent purchase of 64 Medi Mart stores from Stop & Shop.

Key decisions in 70's made Walgreens what it is today

The industry's highest dollar volume drug chain, Walgreens, is today also the industry's most successful company.

The two don't necessarily go together, and there was a period back in the early 1970's and late 1960's when Walgreens was in trouble.

Unlike today, when Walgreens concentrates almost all of its investment dollars and management talent on its nearly 1,300-unit chain of traditional drug stores, Walgreens then was diversified into a variety of business areas: managing a 50% owned combination food/drug store venture with Schnucks, a St. Louis-based food store chain; operating a chain of discount department stores called Globe; overseeing a private label division that sold Walgreens private label products to independents affiliated with Walgreens' agency program; and managing a nearly 50% equity interest in Sanborn Hermanos, S.S., a retailer with diversified businesses in Mexico.

Back then, too, the company was spread thin operationally, struggling to manage a number of marginal stores in undeveloped markets and spending more on new store growth than on remodeling or enhancing existing operations.

During the 10 years between 1965 and 1974, earnings declined and same-store sales growth for the drug stores was erratic.

In 1975, however, Charles R. Walgreen III was named chairman of the board, and the company undertook a massive redeployment of its assets. The result was a much sharper focus on the drug stores as the company's predominant business.

In 1978, Fred F. Canning was named president, and the company temporarily suspended new store expansion to pursue instead a badly needed and extensive store remodeling program.

Many underperforming drug stores were subsequently closed. At the same time, Walgreens began withdrawing from marginal markets where the company's low market share restricted profitability.

In this period, too, management began to consolidate its purchasing and merchandising divisions, and they began to implement programs that tightened the link between merchandisers and buyers at the corporate level and managers and sales personnel at the store level.

Walgreens, at this point, made the critical commitment to developing a superior management information system, a commitment that resulted in Walgreens becoming the first drug chain to automate all pharmacies chainwide, as well as one of the first chains to develop a warehouse inventory system that helped bring in-stock service up to the 95% level. Sources say that only CVS Drugs has a warehouse system as sophisticated or better.

The result is that 10-year compound annual growth rates between FY 75 and FY 85 have been exemplary: drug store sales up 13.7%; net U.S. earnings up 17%; earnings per share up 24%.